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POSITION PAPER

Economic Sanctions

The attached paper on economic sanctions has been prepared in E:ITR - Messrs. Armstrong and Nehmer with the collaboration of NEA, and has been cleared by E - Mr. Bliss.

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~~S E C R E T~~

Economic Sanctions

Anticipated Position of Foreign Governments.

1. The question of invoking economic sanctions against Egypt may be raised in side discussions by foreign governments during the conference. These governments are aware that the Egyptian economy is heavily dependent on raw cotton and that the U. S. has carryover stocks of almost 15 million bales, ten times Egypt's annual production, which, they may believe the U. S. would consider using against Egypt. Furthermore, some foreign governments may believe that if the Suez Conference should be unsuccessful, economic sanctions might be preferable to military action.

2. The basic position of other governments on the question of economic sanctions would probably be one of inquiry. Would the U.S. consider using economic sanctions against Egypt? If so, under what conditions? What kinds of sanctions could be employed? To what extent would they differ from restrictions on trade and payments currently being applied by the U. S.?

3. Certain governments at the Conference, probably Turkey and Pakistan, would undoubtedly express concern over an all-out "dumping" of U. S. raw cotton stocks on the world market as a means of hurting Egypt, because of the serious effects which this would also have on their economies, which are heavily dependent upon cotton.

Recommended U. S. Position.

1. The U. S. Government would support in principle the use of economic sanctions under two conditions; (a) if the Egyptian Government took action to impede navigation through the Canal, or (b) if military action against Egypt by the United Kingdom and France appeared imminent and economic sanctions were the only means of avoiding such action.

2. Before the U. S. Government could agree, however, to accepting comprehensive economic sanctions as a course of action against Egypt if either of the two conditions in paragraph #1 should occur, there would have to be evidence of a desire for cooperation by enough countries to make economic sanctions effective.

3. In the absence of either of the two conditions in paragraph #1 or of the evidence of cooperation referred to in paragraph #2,

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economic sanctions could be counter-productive. If Canal navigation were unimpeded and if military action were not threatened, a program of economic sanctions could alienate a large number of governments of the Near and Middle East, South and Southeast Asia, and possibly, even of Latin America, and possibly could lead to retaliatory action by Egypt to stop navigation in the canal, or action by Arab states to hamper the flow of oil. If sufficient cooperation in applying sanctions were not obtained, they would be not only ineffective but could also create an unnecessary hardship on the economies of a relatively few countries to the benefit of non-cooperating countries.

4. The U. S. Government believes that if economic sanctions were to be invoked, the following could be most effective:

a. The maintenance and tightening of financial controls against Egypt by the U. S., the U. K., and France, and the adoption of similar comprehensive measures by other countries.

b. An embargo on the importation of Egyptian cotton. The achievement of this point could be helped by the use of P.L. 480 agreements with cooperating countries to replace Egyptian cotton.

c. An embargo on the exportation of goods to Egypt.

d. A prohibition on carrying goods to and from Egypt by vessels registered in countries invoking sanctions.

5. The U. S. Government recognizes that the degree of anticipated effectiveness of each of these four actions varies. It does not expect that the actions listed in paragraph #4 can cripple Egypt in the short term or that they can be invoked without some hardship to the countries invoking them. (a), (c) and (d) can be done quickly, if governments wish. (b) takes more time. Other measures short of full scale sanctions, can, of course, be applied; these would include termination of aid, severe control over exports and payments, and shipping restrictions.

Discussion.

1. Egypt's dependence on foreign trade. The Egyptian economy is dependent to a considerable extent on foreign trade. Exports in 1955 totaled E£ 138.4 million,[a] of which raw cotton accounted for 78 percent. About 85 percent of Egypt's dollar earnings came from cotton in that year. Other exports were rice (5 percent), cotton yarn (3 percent), and vegetables (2.5 percent).

Imports in 1955 totaled E£ 182.9 million, of which machinery other than electrical represented 12 percent of the total; petroleum 9 percent; iron and steel 9 percent; electrical machinery 6 percent; wood and wood products 5.5 percent; automobiles and parts 5 percent; chemicals and medicinals 5 percent; and fertilizers 5 percent.

Egypt is a net importer from Western Europe and North America while it is a net exporter in its trade with the Soviet Bloc. The bulk of Egypt's trade is with Western Europe, with 30 percent of Egypt's exports going to European NATO countries in 1955 and 46 percent of Egypt's imports coming from these countries. The Soviet Bloc took 21 percent of Egypt's exports in 1955 and supplied 7 percent of Egypt's imports. The U. S. and Canada took 7 percent of Egypt's exports and supplied 12 percent of its imports.

During the cotton marketing year ending July 31, 1956, 40 percent of Egypt's raw cotton exports went to the Soviet Bloc, a sizeable increase over previous years. Thirty percent went to NATO countries.

The large bulk of Egypt's imports of machinery of various types, automobiles and parts, iron and steel products, chemicals, and fertilizers comes from NATO countries. Petroleum products are imported largely from Saudi Arabia and the U. S. Wood and wood products come largely from Scandinavia and Czechoslovakia. The latter is also somewhat important as a source of cotton textiles for Egypt. Except for these products from Czechoslovakia, Egyptian trade statistics do not show the Soviet Bloc as a major supplier of any particular item in the Egyptian market.

2. Effectiveness

a/ There are 2.87 U. S. dollars per 1 Egyptian pound.

2. Effectiveness of recommended economic sanctions.

a. Maintenance and tightening of financial controls against Egypt. Financial measures against Egypt, which have already been taken in part by the U.S., U.K., and France, might be the most effective of the various kinds of economic sanctions available.

At the end of May, Egypt's "official" foreign exhange assets amounted to $630 million, as follows:

$173 million in gold
$355 million in sterling (already blocked)
$ 70 million in dollars (already blocked)
$ 31 million in other currencies.

Egyptian private assets abroad are not known. They probably are held largely in the U.S., U.K., and Switzerland, but in any case they would be difficult for Egypt to mobilize for national use. Apparently all or virtually all of Egyptian gold is held at home, and not open to blocking. Nearly all Egyptian assets that can be reached have already been subjected to blocking. The situation can be made tighter, however, by covering all Egyptian accounts, both official and private; by having more countries take action along with the U.S., U.K., and France; and particularly by restricting not only Egyptian assets now held abroad but all future financial transactions by Egypt and Egyptians with residents of the cooperating countries or in the currencies of cooperating countries.

This would confine Egypt's trade (including barter trade), shipping, bunkering, etc., to that which it could carry on with third countries in gold, Egyptian pounds (actually credit), or third-country currencies (seldom used in international trade). This would reduce Egypt to barter trade with third countries once its gold was used up, unless third countries were willing to make loans to Egypt.

With such broad financial sanctions, Egypt would not be without some financial means of maneuver, but the pressure on her economy would become increasingly severe, starting with initial shortages of foodstuffs and essential consumer goods, resulting from hoarding.

It should be recognized, however, that broad blocking action by the U.S. along the lines indicated above has been taken in the past only in cases where national security was clearly involved, such as in World War II and the Korean conflict, including the protection of the dollar assets of the invaded countries. Confidence in the U.S. dollar as a world currency and the N.Y. money market could be adversely affected if the U. S. were to resort to such blocking when national security is not clearly involved.

b. Embargo on the importation of Egyptian cotton. An embargo on the importation of Egyptian cotton by the U. S. and other important consumers of Egyptian cotton would cost Egypt the bulk of its transferable currency earnings, including about 85 percent of its dollar earnings. It should be recognized, however, that Egypt's dependence on NATO countries as a market for its cotton is declining as its exports to the Soviet Bloc have increased. Furthermore, this action could cause some hardship to textile industries in Western Europe, particularly the U. K. and France, which use considerable quantities of Egyptian long staple cotton, until Egypt's competitors in this kind of cotton - the Sudan, Peru and the U. S. - could increase their production.

With its huge carryover cotton stocks the U. S. could use authority under the Agricultural Trade Development and Assistance Act of 1954 (P.L. 480) to replace the shorter staples of Egyptian cotton which compete with much of our cotton. This would involve commitments from countries receiving cotton under P.L. 480 agreements that U. S. cotton would, in fact, be used to replace Egyptian rather than other countries' cottons. It should be recognized that time is required to develop and negotiate P.L. 480 agreements. To a limited extent the U. S. could supply long staple cotton as well, but the bulk of long staple supplies, in the short run, would come from Peru and the Sudan, and could not very well be used on concessional terms like those available under P.L. 480.

c. Embargo on exportation of goods to Egypt. Egypt is dependent upon the U. S. and other NATO countries for a wide variety of manufactured products, particularly machinery of all types, automobiles, replacement parts, iron and steel, chemicals and fertilizers. If these countries were to embargo exports to Egypt serious shortages would in time develop. Machinery and equipment in manufacturing industries, in electric power plants, in irrigation pumping stations, and in the railroad system are largely of British, French and Belgian origin.

Egypt might be able to develop alternative sources. It is possible that a country like Japan, unless it cooperated in the economic sanctions against Egypt, could provide a large part of the manufactured products referred to above. The Soviet Bloc might also be a source of supply for such items. Re-exports by countries such as Lebanon or Spain of embargoed items shipped from Western Europe might provide some items unless export controls by the embargoing countries were rigidly enforced.

Such an embargo might create hardships for European manufacturing industries as well. Although Egypt does not loom large in the overall market for European industries it nevertheless represents a traditional market particularly for the United Kingdom and France.

d. Prohibition on carrying goods to and from Egypt by vessels registered in countries invoking sanctions. The bulk of Egypt's foreign trade is handled by vessels registered in the U. S. and in other NATO countries. About 10,000 vessels with a total gross tonnage of 67.3 million are registered in NATO countries. A large part of the tonnage registered in Panama and Liberia, with a gross tonnage in the aggregate of 8.5 million, is owned by U. S. interests. Persuading Panama to cooperate might raise some problems.

If these vessels were withdrawn from the Egyptian trade, shipping might still be available to handle Egypt's foreign trade. Several million gross tons of shipping would theoretically be available to Egypt from Soviet Bloc fleets and those of non-NATO countries. However, the cost of shipping goods to and from Egypt would rise significantly and Egyptian imports and exports would experience delays.

3. Other possible economic measures. The four kinds of economic sanctions described above are believed to be the most effective and the basis of any comprehensive program. Other economic measures, short of a full sanction program, and in addition to fiscal controls now in effect, might include:

a. Possible disposal of U.S. cotton surpluses in competition with Egyptian cotton. (see separate position paper).

b. Terminate U.S. Government technical and developmental assistance operations in Egypt. Point Four assistance is being provided Egypt in a wide number of fields. Approximately $10 million remains in unliquidated funds for Egyptian technical assistance. A development assistance program is currently in effect with approximately $26 million currently unliquidated. The development assistance program is operating in such fields as the railroads, highways, canals and irrigation.

These operations could be terminated by the U.S. by withdrawing personnel and funds. By itself this action would probably have little effect on the Egyptian economy other than to postpone improvements in various phases of the economy and in the standard of living of the Egyptian people.

c. Stringent export controls could be applied to prevent shipment of related items to Egypt, where special vulnerability exists. This might include wheat and pumping equipment, for example.

d. New

d. New tanker construction on a scale large enough to enable shippers of oil to boycott the canal, in time, might be a prudent step. The news of such a program would perhaps be of value in affecting Egypt's judgment. The program would, of course, be very costly indeed.